

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of

THE APPLICATION OF ROWAN WATER, INC.	)	
A NON-PROFIT CORPORATION INCORPORATED	)	
PURSUANT TO CHAPTER 273 OF THE KENTUCKY	)	
REVISED STATUTES, WHICH HAS ITS	)	
PRINCIPAL PLACE OF BUSINESS IN ROWAN	)	
COUNTY, KENTUCKY FOR: (1) A CERTIFICATE	)	
OF PUBLIC CONVENIENCE AND NECESSITY,	)	CASE NO. 8326
AUTHORIZING AND PERMITTING SAID CORPORA-	)	
TION TO CONSTRUCT AN ADDITIONAL WATER	)	
WORKS DISTRIBUTION SYSTEM; (2) APPROVAL	)	
OF THE PROPOSED PLAN OF FINANCING OF	)	
SAID PROJECT; AND (3) APPROVAL OF THE	)	
INCREASED RATES PROPOSED TO BE CHARGED BY	)	
THE CORPORATION TO ITS MEMBER-CUSTOMERS	)	

O R D E R

On August 27, 1981, Rowan Water, Inc., ("Rowan") filed with the Commission an application requesting a certificate of public convenience and necessity authorizing the construction of additions and other improvements to its existing water distribution system and approval of financing the construction project with a loan of \$610,000 from the Farmers Home Administration to be repaid over 40 years at 5 percent interest with principal repayment deferred for the first 2 years. Rowan also requested to adjust its existing rates for providing water service to increase its revenue by approximately \$96,300 annually, an increase of 40.9 percent. Rowan stated that the increase was necessary to cover the additional depreciation and debt cost resulting from the proposed construction and the increase in the cost of water from its wholesale supplier.

On October 27, 1981, the Commission scheduled a hearing for December 3, 1981, and directed Rowan to provide notice to its customers of the hearing and the proposed rate increase. On November 16, 1981, Rowan moved the Commission to grant a continuance of the scheduled hearing due to a delay in advertising the proposed construction project for bids. On November 24, 1981, the Commission, having received Rowan's authorization to waive the 10-month statutory period prescribed in KRS 278.190, ordered the hearing scheduled for December 3, 1981, continued until further notice.

On May 12, 1982, the Commission scheduled a hearing for July 14, 1982, and directed Rowan to provide notice to its customers of the hearing and the proposed rate increase. On May 24, 1982, the hearing was rescheduled for June 23, 1982.

A copy of a letter from the Sanitary Engineering Division of the Kentucky Department for Natural Resources and Environmental Protection approving Rowan's plans and specifications for the proposed construction project is on file with this Commission.

#### COMMENTARY

Rowan is a non-profit water utility engaged in the distribution and sale of water to approximately 1,420 customers in Rowan County, Kentucky. Rowan purchases all of its water from the City of Morehead, Kentucky.

#### TEST PERIOD

Rowan proposed and the Commission has accepted the 12-month period ending May 31, 1981, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

## REVENUE AND EXPENSES

In its Exhibit O Rowan proposed several adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

### Sales Revenue

Rowan proposed a pro forma adjustment of \$96,353 to sales revenue to reflect the sales to the new school which it will serve and the proposed increase in rates. In determining the adjusted operating revenue the Commission has disallowed this adjustment as it reflects rates that have not yet been approved. The Commission has adjusted test year sales revenue by \$4,920 to reflect the additional revenue, at current rates, that would be realized from sales to the new school.

### Purchased Water

Rowan proposed to increase its purchased water cost by \$26,779 to \$95,868 to reflect the increase in water rates of its wholesale supplier. In calculating this adjustment Rowan did not reflect the additional purchases necessary to serve the new school nor did it make any modification for its test year line loss of approximately 28 percent. The Commission is of the opinion that each of these factors should be considered in order to reflect Rowan's pro forma cost of purchased water accurately. Including Rowan's projected sales to the new school the Commission has determined Rowan's annual sales volume to be 98,559,000 gallons. Allowing a maximum line loss of 15 percent at the new rates of Rowan's wholesale

supplier the Commission has calculated Rowan's annual purchased water cost of \$90,957 which results in reducing the proposed adjustment by \$4,911 to \$21,868.

#### Depreciation

Rowan proposed an adjustment of \$12,200 to depreciation expense to reflect the additions to plant proposed of \$610,000. This results in annual depreciation expense of \$44,902 which includes depreciation on total plant including contributed property. The Commission is of the opinion that depreciation on contributed property should not be allowed for rate-making purposes because it provides for the recovery of costs not actually incurred. The record reflects that Rowan's total contributions at the end of the test year amounted to \$342,992, approximately 24.35 percent of total plant in service. Therefore, the Commission has reduced the actual test year depreciation expense by 24.35 percent, or \$7,963, to exclude depreciation on contributed property for rate-making purposes which results in total depreciation expense for rate-making purposes of \$36,939.

#### Rate Case Expense

Rowan estimated its total cost for legal, accounting and engineering work related to this proceeding to be \$4,500 which it proposed to amortize over a 3-year period for rate-making purposes at \$1,500 per year. Inasmuch as this application involved construction and financing, as well as an adjustment of rates, the Commission is

of the opinion that the full amount of these costs should be equally allocated between capitalization and expense for rate-making purposes. Therefore, Rowan's proposed adjustment has been reduced by \$750, or one-half, which the Commission finds to be a reasonable apportionment in this instance.

#### Interest on Long-Term Debt

Rowan proposed an adjustment of \$30,500 to reflect the additional interest cost it would incur through the debt financing of the proposed construction project. The Commission has allowed this adjustment and also has reduced the actual test year interest expense by \$1,255 to include only the interest on long-term debt outstanding at the end of the test period.

The effect of the revised pro forma adjustments on net income is as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$235,206	\$ 4,920	\$240,126
Operating Expenses	201,738	26,855	228,593
Operating Income	\$ 33,468	\$(21,935)	\$ 11,533
Interest on Long-Term Debt	47,346	20,245	76,591
Interest and Other Income	3,623	--0--	3,623
Net Income	<u>\$(10,255)</u>	<u>\$(51,180)</u>	<u>\$(61,435)</u>

#### REVENUE REQUIREMENTS

Historically, the Commission has used the debt service coverage ratio as the criterion for determining revenues for non-profit water utilities and finds no reason to deviate from its established policy in this matter. Using a debt service coverage ratio of 1.5 plus cash operating expenses, the Commission finds Rowan's total revenue requirement to be \$338,479. The increase in

rates requested by Rowan will generate \$3,297 less revenue than the amount found reasonable by the Commission. However, we are of the opinion and find that the rate increase requested by Rowan will produce gross annual revenue sufficient to pay Rowan's operating expenses, service its debt, and provide a reasonable surplus for equity growth, and should therefore be approved.

#### RATE DESIGN

Rowan has proposed to change its rate structure by adjusting the usage levels of the various rate blocks to reflect the actual usage levels of its customers more accurately. The Commission is of the opinion and finds that the proposed rate design will allow Rowan to achieve an equitable allocation of usage and billing charges, thus benefitting both Rowan and its customers, and should therefore be approved as set out in Appendix A.

#### FINDINGS AND ORDER

The Commission having considered Rowan's request for approval of its proposed construction, financing and adjustment of rates, is of the opinion and finds that:

- 1) Rowan's request for approval of its proposed adjustment of rates is just and reasonable and in the public interest, and should be approved.
- 2) Public convenience and necessity require that the construction proposed in the application be performed and that a certificate of public convenience and necessity be granted.
- 3) The proposed construction will be for comprehensive improvements and expansion of the existing distribution system. It

will provide for the flow and storage of the larger quantities of water needed to serve new customers and to improve the quality of service to existing customers. No additional revenues, other than from sales to the new school, are anticipated from this construction which includes a 150,000-gallon standpipe type storage tank on KY 32, 8,215 feet of 12-inch water main, 8,000 feet of 10-inch water main, 18,620 feet of 8-inch pipe, a new pumping station and other improvements at a project cost of \$610,500.

4) Any construction deviations from the contract plans and specifications herein approved which could adversely affect service to any customer should be subject to the prior approval of this Commission.

5) The proposed borrowing of \$610,000 at an interest rate of 5 percent from the Farmers Home Administration is for lawful objects within the corporate purposes of Rowan, is necessary and appropriate for and consistent with the proper performance of services to the public by Rowan, will not impair its ability to perform these services and is reasonably necessary and appropriate for such purposes.

6) Rowan should furnish this Commission with duly verified documentation of the total cost of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

7) The contract between Rowan and its engineer should require the engineer to provide general engineering supervision and full-time resident inspection under his or her supervision to

insure that the construction work conforms to the best construction practices and is done in accordance with the contract plans and specifications.

8) Rowan should require the engineer to furnish this Commission with a copy of the as-built plans and a certification that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date that construction is substantially completed.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Rowan on and after the date of this Order.

IT IS FURTHER ORDERED that Rowan be and it hereby is granted a certificate of public convenience and necessity to proceed with the proposed construction as set forth in the plans and specifications of record herein.

IT IS FURTHER ORDERED that any construction deviations from the contract plans and specifications which could adversely affect service to any customer shall be subject to the prior approval of this Commission.

IT IS FURTHER ORDERED that Rowan be and it hereby is authorized to borrow \$610,000 from the Farmers Home Administration at 5 percent interest over a 40-year period with payment of principal deferred for 2 years and to issue waterworks revenue bonds as security therefor.

IT IS FURTHER ORDERED that Rowan shall file with this Commission duly verified documentation which shows the total costs of the construction herein certificated including all capitalized



costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

IT IS FURTHER ORDERED that the contract between Rowan and its engineer shall require the engineer to provide general engineering supervision and full-time resident inspection under his or her supervision to insure that the contractor's construction work conforms to the best construction practices and is done in accordance with the contract plans and specifications.

IT IS FURTHER ORDERED that Rowan shall require its engineer within 60 days of the date of substantial completion of the proposed construction, to furnish this Commission with as-built drawings and a certification that the construction has been satisfactorily completed and was done in accordance with the contract plans and specifications.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Rowan shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 26th day of July, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Vohs  
Chairman

Katharine Randall  
Vice Chairman

L. L. Langston  
Commissioner

ATTEST:

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Secretary

## APPENDIX A

### APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8326 DATED JULY 26, 1982

The following rates are prescribed for the customers in the area served by Rowan Water, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

RATES: Monthly

#### 5/8 INCH METER

First	2,000 gallons	\$8.90 Minimum Bill
Next	3,000 gallons	3.20 per 1,000 gallons
Next	10,000 gallons	2.80 per 1,000 gallons
Next	10,000 gallons	2.40 per 1,000 gallons
Next	10,000 gallons	2.20 per 1,000 gallons
Next	15,000 gallons	2.00 per 1,000 gallons
Over	50,000 gallons	1.75 per 1,000 gallons

#### 3/4 INCH METER

First	4,000 gallons	\$15.30 Minimum Bill
Next	1,000 gallons	3.20 per 1,000 gallons
Next	10,000 gallons	2.80 per 1,000 gallons
Next	10,000 gallons	2.40 per 1,000 gallons
Next	10,000 gallons	2.20 per 1,000 gallons
Next	15,000 gallons	2.00 per 1,000 gallons
Over	50,000 gallons	1.75 per 1,000 gallons

#### 1 INCH METER

First	5,000 gallons	\$18.50 Minimum Bill
Next	10,000 gallons	2.80 per 1,000 gallons
Next	10,000 gallons	2.40 per 1,000 gallons
Next	10,000 gallons	2.20 per 1,000 gallons
Next	15,000 gallons	2.00 per 1,000 gallons
Over	50,000 gallons	1.75 per 1,000 gallons

1 1/2 INCH METER

First 15,000 gallons  
Next 10,000 gallons  
Next 10,000 gallons  
Next 15,000 gallons  
Over 50,000 gallons

\$46.50 Minimum Bill  
2.40 per 1,000 gallons  
2.20 per 1,000 gallons  
2.00 per 1,000 gallons  
1.75 per 1,000 gallons

2 INCH METER

First 25,000 gallons  
Next 10,000 gallons  
Next 15,000 gallons  
Over 50,000 gallons

\$70.50 Minimum Bill  
2.20 per 1,000 gallons  
2.00 per 1,000 gallons  
1.75 per 1,000 gallons